



INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-4704

June 10, 2004

MEMORANDUM FOR INSPECTOR GENERAL, NATIONAL RECONNAISSANCE OFFICE

SUBJECT: Quality Control Review of the Assistant Inspector General for Audits
Office of the Inspector General, National Reconnaissance Office
(Report No. D2004-6-005)

We have reviewed the Office of the Assistant Inspector General for Audits (OAIGA), Office of the Inspector General, National Reconnaissance Office (NRO) system of quality control for the year ended July 31, 2003. The Government Auditing Standards require that an audit organization performing Government audits have an appropriate internal quality control system and undergo an external quality control review every 3 years by an organization that is not affiliated with the organization reviewed. As the organization that has audit policy and oversight responsibilities for audits in the DoD, we facilitated and oversaw the conduct of this quality control review of the NRO OAIGA. To avoid unnecessary duplication and disruption, we conducted the audit quality control review of NRO OAIGA concurrently with the management review of the NRO Office of the Inspector General. The Office of the Deputy Inspector General for Intelligence, Office of the Inspector General of the Department of Defense, jointly conducted the management review with the Office of the Inspector General, Central Intelligence Agency.

An audit organization's quality control policies and procedures should be appropriately comprehensive and suitably designed to provide reasonable assurance of meeting the objectives of quality control. We tested the OAIGA system of quality control to the extent considered appropriate.

The NRO OAIGA designed their system of quality control in effect for the year ended July 31, 2003, in accordance with quality standards. They also complied with the system to provide reasonable assurance of material compliance with professional auditing standards in conducting its audits. Therefore, we are issuing an unqualified opinion on the audit quality control system. The scope and methodology of our review is at Appendix A. Comments and observations that did not affect the overall opinion and recommendations for corrective actions are at Appendix B and should be read in conjunction with the report.

The Inspector General NRO provided comments to a draft of this report, which are attached. We considered his comments when preparing the final report. Please provide comments and planned corrective actions to the revised recommendations on page 6 and clarify comments to the recommendation on page 9 of Appendix B by July 26, 2004. Please call Ms. Carolyn R. Davis at (703) 604-8877 if you have any questions. See Appendix C for the report distribution.

Patricia A. Brannin
Assistant Inspector General
for Audit Policy and Oversight

Attachments

Report Documentation Page				Form Approved OMB No. 0704-0188	
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Appendix A. Scope and Methodology

The mission of the NRO is to develop and operate unique and innovative space reconnaissance systems and conduct intelligence-related activities essential for the national security of the United States. The Director, NRO, delegated the authority and responsibility to conduct audits within the NRO to the Inspector General (IG), NRO. Personnel within the NRO Office of the Assistant Inspector General for Audits (OAIGA) execute the audits within NRO. The OAIGA is responsible for enhancing economy, efficiency, effectiveness, and accountability within the NRO by performing independent audits of NRO operations and programs. The OAIGA also makes recommendations to correct problems and deficiencies identified by the independent audits; keeps the Director, NRO, informed; and promotes effectiveness in the administration of NRO operations and programs. The NRO Inspector General Audit Policy & Procedures Manual, dated May 1, 2000, and the Draft National Reconnaissance Office Inspector General Audit Policy & Procedures Manual, dated March 2003, provide guidance on the operation of audits within the NRO OAIGA.

The review team tested compliance with the OAIGA system of quality control to the extent considered appropriate. The tests included reviewing a judgmental sample of six of nine audit reports issued by the NRO OAIGA during the year ended July 31, 2003.

From July 2003 through January 2004, the external review team conducted a review of the audit quality control function for the NRO Office of the Inspector General in effect for the period from August 1, 2002, through July 31, 2003. The team used the guidelines and checklists established by the President's Council on Integrity and Efficiency as amended February 2002 to ensure that the review was in conformance with GAS. The review team adjusted the President's Council on Integrity and Efficiency (PCIE) guidelines and checklists as appropriate. In applying the PCIE guidelines, the review team considered several factors such as the size of the OAIGA, the degree of autonomy allowed, and the nature of the work. The review team reviewed working papers for the selected audits, conducted interviews of professional and administrative staff members, and performed tests of documentation.

We used the 1994 version of the Government Auditing Standards, as amended, including the amendment of the Independence Standard, which became effective in January 2003. Where appropriate we have provided suggestions for modifying operating procedures based on the 2003 version of the Government Auditing Standards, which became effective January 1, 2004.

Limitations of Review. Our review would not necessarily disclose all weaknesses in the system of quality control or all instances of noncompliance with it because we based our review on selective tests. There are inherent limitations in considering the potential effectiveness of any quality control system. In performing most control procedures, departures can result from misunderstanding of instructions, mistakes of judgment, carelessness, or other human factors. Projecting any evaluation of a quality control system into the future is subject to the risk that one or more procedures may become inadequate because conditions may change or the degree of compliance with procedures may deteriorate.

Review Team Composition. The audit quality control system review team consisted of representatives from the Offices of the Assistant Inspectors General for Auditing, the National Geospatial-Intelligence Agency, the National Security Agency, and the Central Intelligence Agency (CIA). The Office of the Assistant Inspector General for Audit Policy and Oversight, DoD provided oversight and prepared the report.

Acronyms

CIA	Central Intelligence Agency
GAS	Government Auditing Standards
IPA	Independent Public Accountant
NRO	National Reconnaissance Office
OAIGA	Office of the Assistant Inspector General for Audits
OPM	Office of Personnel Management
PCIE	President's Council on Integrity and Efficiency
RFP	Request for Proposal
SOW	Statement of Work

Appendix B. Comments and Observations

Based on our review, we have the following comments, observations, and recommendations. These comments and observations did not affect our overall unqualified opinion. However, the NRO OAIGA needs to continue its diligence to maintain an effective system. Implementing the recommendations would improve the quality control system and help to maintain an unqualified opinion. We received comments from the IG, NRO on a draft of this report. We have made changes accordingly, summarized the comments below, and included a copy of the comments.

Qualification Requirements for National Reconnaissance Office Audit Staff. The NRO staff collectively possessed professional proficiency to perform the audits. However, we identified one member of the OAIGA staff who was classified as an auditor but did not meet the usual requirements for an auditor position.

The individual had two degrees, one in Political Science and one in International Relations, and had 19 years of information technology experience. The individual lacked accounting or audit education and experience before taking this position. We were told that the OAIGA uses the CIA qualifications standards, so we contacted the CIA Human Resources office to obtain a copy of their auditor qualification standards. The CIA Human Resources office referred us to the Assistant Inspectors General for Audits for CIA and NRO. Office of the Inspector General CIA personnel had previously provided us with three CIA job announcements that we were told included basic auditor qualifications. Based on the three job announcements, the basic qualifications for auditor positions are:

- a college degree in accounting, finance, information systems, or business management with a solid academic record. Applicants were required or encouraged to have a degree with a major in one of these disciplines.
- 2 to 5 years experience in conducting or participating in audits of Federal financial statements or in government auditing, accounting, or information systems as preferred or required.

The job announcements ranged in grades from GS-9 through GS-13 with career growth potential to GS-15 and beyond. The OAIGA hired the individual in question as a GS-14 although that individual did not meet any of the basic auditor qualifications that we were given.

The OAIGA stated that it uses its own job announcements, which it did in this case to hire the individual. The qualification standards for the job announcement against which the individual in question was hired were:

- a college degree and specialized experience in work, which will enable the applicant to perform successfully the duties of the position, and
- experience typically related to such things as evaluating compliance with laws and regulations, or assessing the effectiveness, economy and efficiency of resource utilization; management processes and procedures; and in achieving mission objectives.

OAIGA can and should have technical specialists to provide specific knowledge and skills, such as information technology. However, we believe that the NRO OAIGA should have well-defined and consistent qualification standards for hiring its auditors.

The Government Auditing Standards require that the audit team collectively possess adequate professional competence for the tasks assigned. Although the Government Auditing Standards do not address qualifications for auditors or other specialists in an audit organization, the designation of auditor has specific expectations of education and experience in the Government auditing community. Like the Government Auditing Standards, the PCIE* in the “Quality Standards for Federal Offices of Inspector General,” October 2003, paragraph VIII. C., Core Competencies, states that staff members must collectively possess the professional competence to perform the work assigned. However, the PCIE standards further state that “staff must individually meet requirements established by the Office of Personnel Management (OPM) for their respective job series and by applicable professional standards.” The OPM requirements for auditors are a degree in accounting or related field such as business administration, finance, or public administration that includes or is supplemented by 24 semester hours in accounting. The OPM requirements for auditors allow for a combination of education and experience that includes at least 4 years of experience in accounting or an equivalent combination of accounting experience, college-level education, and training that provides knowledge of professional accounting.

Both the IG DoD and the IG CIA are members of the PCIE. Because NRO operates under both DoD and CIA authorities, we believe that the OAIGA should adopt the PCIE qualification standard for its auditor positions. Such an action is consistent with other Federal audit organizations, which have personnel systems that do not follow OPM guidelines, but use the OPM standards for auditors within their organizations and use other designations for positions that do not meet those qualifications.

Recommendation. We recommend that the Assistant Inspector General for Audits, Office of the Inspector General, National Reconnaissance Office:

- Re-designate the individual who does not meet the basic auditor requirements to a position designation more in line with the individual’s education and experience.
- Establish consistent minimum qualifications of its staff members in accordance with PCIE standards.

Management Comments. In a response to a draft of this report, the IG NRO nonconcurred with the recommendation to re-designate the individual stating that neither the new nor prior CIA personnel management systems allowed them to do so. The IG NRO maintains that the individual meets the OPM defined standard. The IG NRO concurred in principle with the recommendation to establish consistent minimum qualifications stating that any vacancy announcements will include minimum education qualifications as well as audit experience requirements for the entry through expert level auditor.

Our Response. After reviewing additional information provided by the AIGA, we continue to disagree that the one auditor met the OPM requirements as an auditor and continue to believe that the individual did not meet the “usual” qualifications for an auditor as used by the

*The Executive Council on Integrity and Efficiency, which includes non-statutory Federal Inspectors General, are also a party to the Quality Standards for Federal Offices of Inspector General.

CIA. We continue to believe that the IG and AIGA could best serve the NRO audit organization by working with the CIA personnel management staff to determine a way to include subject matter experts within the audit office if future requirements dictate, rather than hire someone as an auditor without minimum qualifications. Although the IG NRO did not opt to implement the PCIE standard to use the OPM requirements for its auditors, they have indicated that they have minimum qualifications that will be used to hire auditors. The identification of minimum qualification standards for the different “grade” levels and the consistent application of those qualification standards when recruiting and hiring auditors meets the intent of our recommendation. However, we believe that AIGA should not establish auditor qualification standards that are significantly different from qualification standards used by other Government audit organizations. Other audit organizations within the PCIE/ECIE community and the General Accounting Office use the OPM standards when designating someone as an “auditor.” However, they recognize that other education and experiences are appropriate to provide competent staff for their audits and will hire other staff other than “auditors,” but they generally designate the individuals as something other than auditor, such as evaluator.

Qualifications of Independent Public Accountant Staff. Section L of the Request for Proposal (RFP) for the contract on the NRO FY 2002 Financial Statements Audits established minimum “satisfactory” qualifications of education and experience for the Independent Public Accountant (IPA) staff - Project Manager and three key audit positions. The minimum contractual educational and experience requirements for key positions #2 and #3 were either CPA or meet the CPA educational requirements in the state employed, bachelors degree in accounting or business, and a minimum of 5 years and 2 years, respectively, of general audit experience, with desired experience in CFO audit work. In addition, RFP Clause I-12 specified that all proposed substitutes for the key personnel must have “qualifications that are equal to or higher than the qualifications of the person to be replaced.”

For the NRO financial statement audit, the IPA contractor had a pattern of replacing staff with other staff with lower qualifications despite the requirements. For key position #2, the OAIGA accepted a replacement that did not meet the contract requirements because the IPA stated that they had no other staff available to put on the NRO financial statement audits. For key position #2, the reduced requirements were offset somewhat because the auditor had prior experience with NRO financial statement audits. For key position #3, the OAIGA accepted a replacement that met the requirements for education and experience but did not satisfy the Clause I-12 requirement for equal to or higher than the person replaced.

Given that two key personnel did not fully meet the requirements in the RFP, additional quality control reviews could provide increased assurance of the adequacy of the work. According to NRO audit staff, as a condition of accepting an individual without the same or higher qualifications, the person in key position #1 increased the number of hours so that NRO IG would be comfortable with the level of supervision on the audit. This was in accordance with the statement of work (SOW) section 9.3, which requires the contractor to provide sufficient senior qualified personnel to review working papers and direct senior and junior auditors.

OAIGA staff indicated that they will reassess the key personnel clause for future contracted audit services to determine whether the qualification requirements are appropriate. They expressed an intention to consider lowering the qualification requirements as opposed to having the IPA meet the current minimum certification, education, and experience requirements. We believe the current “satisfactory” requirements delineated in the RFP for IPA staff are reasonable. We also believe that Clause I-12, is potentially in conflict with Section L, key personnel requirements.

Recommendation. Along with reassessing the appropriate level of audit education, experience, and certification for Independent Public Accountant staff, we recommend that the Assistant Inspector General for Audits in preparing the RFP and contract for the next contract for financial audit services work with the NRO acquisition and contracting officials to:

- Establish RFP requirements that reflect the intent and need to obtain qualified contract audit staff and maintain the qualified staff throughout the contract performance; and
- Ensure that statement of work contains the same material clauses as the RFP regarding contract personnel qualifications and substitution and replacement clauses.

Management Comments. In response to a draft of this report, the IG NRO concurred in principle with the recommendations to establish procedures for additional oversight and include contract provisions for additional oversight. However, they stated that the existing SOW includes adequate procedures. They will reexamine the procedures before issuing the next contract. The IG NRO nonconcurred with the recommendations to delete Clause I-12 because the NRO Acquisition Manual requires the clause. They also nonconcurred with the need to modify the contract because the current contract ends in January 2005.

Our Response. We revised our recommendation based on the IG comments and subsequent information requested in conjunction with those comments. We request that the IG NRO provide comments to the revised recommendations.

Based on our review of the referenced SOW clauses, we disagree that the clauses meet the intent of our recommendation to establish additional oversight procedures or actions if the contractor does not meet the contractual requirements, nor was there consideration for not meeting the contract requirements on qualifications of substituted personnel. The referenced clauses give the contractor supervision and management requirements for contract compliance. We, however, deleted those recommendations in light of revised recommendations as discussed below. In the future, the NRO OAIGA staff should work with the contracting officer to ensure that the contractor meets the contractual requirements.

Our review of the Acquisition Manual requirements does not support the IG comment that the manual requires the Clause I-12. The Acquisition Manual states “Because of the restrictive nature of the requirement, the determination to use this clause should be made only in exceptional cases.” We do not believe that such a statement implies that the clause is required. Also, the Clause I-12 is different from the SOW clause 9.4. Clause I-12 was more restrictive than what was included in the SOW. Clause I-12 required that a substituted key person have equal to or higher qualifications than **the person replaced**. The SOW clause 9.4, Substitution and Rotation of Personnel, stated that proposed personnel replacements must meet or exceed the minimum professional experience, qualifications, capabilities, and security clearances **required by this contract**. Also, the SOW clause 9.4 did not include or define the “minimum” professional experience, qualifications and capabilities. However, the RFP gave “satisfactory requirements” for the key positions in the RFP.

We recognize that there are a number of ways to originally assemble a competent audit team for the contract and to retain the competency of the team. However, when the qualifications in the RFP do not match up with the SOW, or the contract requirements are not enforced, offerors that lost the competition could question the fairness of the solicitation. The SOW becomes the binding document and it should contain important provisions from the RFP.

We believe minimum qualifications for auditors and managers of the financial statement audit contract are a material factor and important to the competition and to the performance of the audit. We also believe that the substitution clause should be the same in the RFP and the SOW. We continue to believe that the minimum qualification requirements in the RFP and the requirements of Clause I-12 are potentially contradictory. The AIGA has stated that they are reassessing the minimum auditor requirements to have a successful adequate audit of the NRO financial statements audits in accordance with Government Auditing Standards. In conjunction with the reassessment, we believe that the OAIGA should work with the NRO acquisition and contracting staff to reassess how best to ensure that the audit team will meet the NRO needs and what substitution requirements are appropriate. They should also work with the NRO acquisition and contracting staff to ensure that the RFP and the SOW are consistent. We have revised our recommendations to reflect the IG comments and analysis of additional information provided.

The contractor did not meet the terms of the contract in relation to staff qualifications for new staff assigned to the team. We intended our recommendation to modify the contract in the event of changes in its terms and conditions for future contracts as well as the current contract. If the terms and conditions are changed without appropriate contract modifications, NRO is potentially at risk in contract close out and future contract actions. We have deleted the recommendation related to modifying the contract because we believe that the revised recommendations if properly implemented, can eliminate the issues we identified. However, NRO must ensure that the contractor comply with the terms and conditions of the contracts; otherwise, a modification is necessary.

Auditor Independence. The revision to the Government Auditing Independence Standard, effective January 2003, significantly strengthened the standard. The Comptroller General stated that “protecting the public interest and ensuring public confidence in the independence of auditors of government financial statements, programs, and operations, in both form and substance” were paramount in his decision to issue these new standards. The standard requires that the audit organization have an internal quality control system in place to help determine whether auditors have any personal impairment to independence that could affect their impartiality or the appearance of impartiality. Auditors are responsible for notifying the appropriate officials within their audit organizations if they have any personal impairment to independence. The revision also significantly strengthened the standard as it relates to non-audit work.

NRO Staff Independence Guidance. The NRO Office of the Inspector General Audit Manual placed responsibility on auditors to notify the Assistant Inspector General for Audits or other Office of the Inspector General management official in writing of any personal impairment to their independence. The Auditor-in-Charge (supervisor) is responsible to ensure that the audit file addresses the requirement and includes evidence of compliance. We identified two instances where documentation in the working papers identified that auditors notified their supervisors of conflicts of interest. The analysis of the independence issue was in the working papers. The OAIGA Quality Checklist addresses after-the-fact independence issues by questioning working paper contents on impairments and report disclosure. However, given the emphasis on audit and audit organization independence in recent years both within and outside Government, we believe that NRO should consider a more proactive approach to its independence quality control processes. For example, two common ways used in other audit organizations are that: (1) auditors certify at the beginning of an audit to personal independence relative to that audit and (2) auditors include a certification as part of their time/attendance documentation to their

personal independence relative to audit(s) or other projects worked on during that pay period. In either case, the policy should require that the auditors notify their supervisors of any changes subsequent to certification and that appropriate action be taken. According to the Assistant Inspector General for Audits, the audit staff has begun to document auditor independence at the outset of an audit. The quality control process should:

- stress the “in fact and appearance” aspects of independence;
- address potential actions or mitigating factors to consider when deciding on appropriate actions to take if potential impairments to independence issues are identified; and
- address the need to include any pertinent issues related to independence impairments in the scope and methodology section of the audit reports.

The NRO Inspector General Audit Policy and Procedures Manual also does not address the impairment to both personal and organizational independence for non-audit work, and the safeguards that must be put in place if non-audit work is done.

Recommendation. We recommend that the Assistant Inspector General for Audits revise and strengthen procedures to provide more proactive quality control measures to comply with the GAS independence standard and include procedures and processes to safeguard personal and organizational independence related to non-audit work. Such procedures could include:

- providing guidance for the proper use and reporting of scope limitations when independence is impaired;
- providing procedures when non-audit services have been performed for the audit client; and
- providing procedures if changes in independence occur.

Management Comments. The IG NRO concurred with the recommendation.

IPA Independence Documentation Requirements. The contractor staff that performed the financial statement audit signed a contractor form, Independence Confirmation for US Engagement Personnel. This form is a standard form for this particular contractor and does not speak to nor cite GAS. The form’s focus is toward an audit of a non-government organization although it indicates “...applicable rules with respect to the National Reconnaissance Office.” The form addresses some but not many of the independence elements included in GAS. For example, the form does not address preconceived ideas toward individuals, groups, organizations, or objectives of a particular program that could bias the audit; biases, including those induced by political or social convictions, that result from employment in, or loyalty to, a particular group, organization, or level of government; or relevant non-audit work. OAIGA believes that the security requirements used by NRO, including the polygraph examination, provide assurance of an employee’s honesty and integrity, and the thorough background investigation that an IPA employee must undergo gives additional credence that the employee is meeting independence standards in regard to preconceived ideas. We agree with the AIGA that a certification does not necessarily have to cover all possible actions, but it should explicitly address GAS and non-audit work.

In his January 2002 press release issuing the new Government Auditing Standards on independence, the Comptroller General of the United States urged the American Institute of Certified Public Accountants to raise its standards to those contained in Government Auditing Standards. Therefore, NRO should have procedures to ensure that its contractors comply with the intent of the Government independence standards “in both fact and appearance.”

Recommendation. We recommend that the Assistant Inspector General for Audits include in its RFP and contracts for audit services specific requirements for complying with the Government Auditing Standard on Independence and required documentation to ensure that the organization as well as the individual auditors are complying with the independence standard. The RFP and statement of work should include compliance with standards related to non-audit work by both the organization and individual auditors related to the audit objectives and NRO.

Management Comments. The IG NRO concurred with the recommendation. However, the IG NRO further stated that the IPA would not be performing non-audit work as part of this contract.

Our Response. The proposed action is partially responsive to our recommendation. The comments indicate a misunderstanding of the recommended action; therefore, we request the IG, NRO reassess and clarify his comments to this recommendation. The purpose of the recommendation is to ensure that potential contractors specifically address potential impairments to independence based on non-audit work that the IPA performed or plans to perform as a part of other contract(s) or work done, not just the contract in process. For example, the IPA or a IPA staff assigned to the contract could have performed non-audit work for another NRO organization that is material or significant to the NRO financial statements. Therefore, we reiterate the need for the contractor to specifically address the non-audit work by both the organization and the individual auditors. The contractor should be required to identify any non-audit work that the contractor or their assigned staff have done or plan to do that could relate to the audit objectives or organizations that the contractor will audit. The NRO OAIGA can then determine if non-audit work is material or significant and take appropriate actions, which could include qualify the audit report, institute safeguards, or disqualify the contractor or individual staff member.

Financial Statement Audit-Contractor Oversight and Quality Assurance Working Papers and Quality Assurance Plan. The Acting NRO Inspector General transmitted the FY 2002 financial statements audit report by a memorandum in which he stated that the audit was done in accordance with standards and that he agreed with the IPA opinion. However, the majority of NRO Office of the Inspector General contractor oversight and quality assurance working papers were not prepared and reviewed until after the audit report on the FY 2002 financial statements and the transmittal memorandum agreeing with the conclusions were issued in January 2003. The 2003 version of GAS emphasizes “Audit documentation should contain support for findings, conclusions, and recommendations before auditors issue their report.” Although not technically an audit, we believe that the concept applies to the contract oversight documentation for the financial statement audit.

The quality assurance plan for the financial statement audit, which was very detailed and rigorous, included both oversight steps conducted during the audit and quality assurance procedures that were completed after the audit report was issued. The oversight section should reflect the GAO/PCIE Financial Audit Manual, section 650, “Using the Work of Others.” The NRO Office of the Inspector General can ensure the quality of the audit by completing and documenting steps similar to those required in GAO/PCIE section 650, “Using the Work of

Others,” before issuing the transmittal memorandum attesting to its agreement with the IPA audit results. The staff can do the additional quality assurance reviews steps after the report is issued and form the basis for best practices or lessons learned.

Although we recognize the strict statutory requirements and timelines placed on financial statement opinion audits, the oversight working papers that support the endorsement memorandum and oversight report and verify execution of the GAO/PCIE Financial Audit Manual Section 650 steps should be completed before issuing the report. We also recognize that NRO OAIGA staff was substantially overseeing the work that IPA performed during the course of the IPA audit. NRO OAIGA staff should complete the documentation of contract oversight review of the IPA work before issuing its conclusion concerning the adequacy of the IPA work in the audit report.

Recommendation. We recommend that the Assistant Inspector General for Audits revise its oversight procedures to (1) ensure that documentation of its oversight is complete before issuing its transmittal report accepting the contractor’s opinions, conclusions, and recommendations and (2) perform quality assurance procedures after report issuance for lessons learned separate from oversight procedures.

Management Comments. The IG NRO concurred with the recommendation.

Transmittal Memorandum for the FY 2002 Financial Statement Audits. In its memorandum transmitting the FY 2002 financial statement audit report, the IG NRO expressed agreement with the IPA opinion, findings, and conclusions. However, the transmittal memorandum did not clearly indicate to what extent the OAIGA performed the contractor oversight and quality assurance review and any limitations on that review. The transmittal memorandum also did not acknowledge that the IPA had not completed all its working papers at the time it had provided its opinion. For example, the working papers documenting the OAIGA oversight of the IPA contract audit staff for the FY 2002 financial statements audit state that the Office of the Inspector General did not have sufficient time to ascertain whether all findings were supported or whether all significant matters had been included in the report. Despite the statement in the working papers, the audit report did not include a scope limitation and the known effect on the audit results in accordance with GAS, paragraph 3.29 (1994 version). In addition, the contractor had not completed its working papers before issuing its reports. This is contrary to the 2003 revision to GAS.

Based on discussion during our review, the Assistant Inspector General for Audits revised the transmittal letter to eliminate any confusion and now states that the Office of the Inspector General conducted sufficient review of the IPA work in order to satisfy themselves that the audit opinion is supported.

Appendix C. Report Distribution

Other Defense Organizations

Director, National Reconnaissance Office
Inspector General, National Reconnaissance Office

Congressional Committees and Subcommittees, Chairman and Ranking Minority Member

Senate Committee on Appropriations
Senate Subcommittee on Defense, Committee on Appropriations
Senate Committee on Armed Services
Senate Committee on Governmental Affairs
House Committee on Appropriations
House Subcommittee on Defense, Committee on Appropriations
House Committee on Armed Services
House Committee on Government Reform
House Subcommittee on Government Efficiency, Financial Management, and Intergovernmental Relations, Committee on Government Reform
House Subcommittee on National Security, Veterans Affairs, and International Relations, Committee on Government Reform

National Reconnaissance Office

Comments



NATIONAL RECONNAISSANCE OFFICE

14675 Lee Road
Chantilly, VA 20151-1715

Office of Inspector General



24 May 2004

MEMORANDUM FOR ASSISTANT INSPECTOR GENERAL FOR POLICY AND OVERSIGHT

SUBJECT: Response to the Quality Control Review of the National
Reconnaissance Office, Office of Inspector General,
Assistant Inspector General for Audits

We have reviewed the Peer Review Report dated 9 March 2004, as amended on 21 May 2004 and offer the attached comments. We appreciate the "unqualified" opinion reached by your review team. Since the prior peer review in 1998, this office has strived to address identified weaknesses, established quality control procedures, and conducted quality audits in support of the National Reconnaissance Office mission. Your positive review demonstrates that we have been successful in these efforts.

If you have any questions, please contact Mr. Robert Vignola, Assistant Inspector General for Audits, at (703) 808-2254.

Eric R. Feldman
Inspector General

Attachment:
Response to Peer Review
Report dated 9 March 2004

**Qualification Requirements for National Reconnaissance Office
Audit Staff**

The Peer Review team identified one member of the NRO OIG audit staff classified as an auditor who did not meet the usual auditor requirements for the CIA/NRO. The Peer Review team believes that the OIG should have well defined and consistent minimum standards for its positions in order to continue to meet its competency standard.

Peer Review Recommendation: Re-designate the individual who does not meet the basic auditor requirements to a position designation more in line with the individual's education and experience.

NRO IG Response: Non-concur. Although we mutually agree that it is appropriate and beneficial to have technical expertise on the audit staff, we cannot concur with this recommendation. The individual in question was hired as a part-time employee for her specific expertise in information systems. Nevertheless, it is our view that she meets the OPM defined standard with a combination of 30 semester hours in accounting, economics, and business, as well as experience in professional accounting. However, neither the new nor the former CIA personnel management systems afford us the flexibility to designate the individual as anything but an auditor. Under the new system, an individual assigned to the audit staff is designated either as an entry, developmental, full performance, senior or expert auditor. There is no GS grade or OPM job series designation. Placement in a given level is dependent on the individual's demonstrated experience, including education. Furthermore, specific performance objectives will be developed for each individual. Through this process we can ensure that this individual's work assignments are commensurate with their skill levels.

Peer Review Recommendation: Establish consistent minimum qualifications of its staff members in accordance with PCIE standards.

NRO IG Response: Concur in principle. The new CIA system will include detailed position descriptions, performance standards and promotion criteria that address the entry through expert level auditor. The position descriptions and any vacancy

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announcements will include minimum education qualifications, to include Bachelor's degree in a relevant area of study, such as Accounting, Finance, Information Technology, or business, as well as audit experience requirements.

Qualifications of Independent Public Accountant Staff

The Peer Review noted that the Independent Public Accountant (IPA) contractor had a pattern of replacing assigned staff with other staff who had lower qualifications inconsistent with contract requirements.

Peer Review Recommendation: Establish procedures that provide for additional oversight if future events lead to accepting contracted auditors who do not meet contractual requirements.

Revised

NRO IG Response: Concur in principle. The existing Statement of Work (SOW) sections 9.0 - 9.4 already include these procedures. We believe these procedures are adequate but will reexamine them before issuing the next contract.

Peer Review Recommendation: Include in its contract for audit services provisions to ensure additional IPA oversight of audits if future events lead to accepting contracted auditors that do not meet contractual requirements.

Revised

NRO IG Response: Concur in principle. As stated above, the existing Statement of Work sections 9.0 - 9.4 already include these procedures. Those procedures effectively allowed us to increase the number of hours of IPA management to ensure contractor performance.

Peer Review Recommendation: Consider deleting Clause I-12 specifying that all proposed substitutes for key personnel have qualifications that are equal to or higher than the qualifications of the person to be replaced.

Revised

NRO IG Response: Non-concur. This clause is required by the NRO Acquisition Manual and cannot be deleted. However, we are evaluating our key personnel needs for the next contract, which should enable us to appropriately manage this process.

Revised

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Peer Review Recommendation: Ensure the contract is properly modified and consideration provided to reflect changes in requirements during the course of the contract.

NRO IG Response: Non-concur. The subject contract ends January 2005, so there is little value to modifying it. In our view, the NRO had received appropriate consideration for the replacement personnel. As the peer review team was informed, the rates used are commensurate with the experience and certification levels of each individual. The NRO OIG believes that we received the same or better quality at a lower rate.

NRO Staff Independence Guidance

The Peer Review team observed through their review of the audit workpapers that NRO OIG auditors notified their managers of conflicts of interest (COI). The team believes that the OIG should establish a more proactive process for identifying potential conflicts, and develop procedures for reporting changes in COI status. The team also noted that the audit manual does not address the safeguards that must be in place in the event that non-audit work is done.

Peer Review Recommendation: We recommend that the Assistant Inspector General for Audits revise and strengthen procedures to provide more proactive quality control procedures to comply with GAS independence standard and include procedures and process to safeguard personal and organizational independence relative to non-audit work.

NRO IG Response: Concur. We will amend our audit manual to fully reflect the updates concerning auditor independence included in the revised Government Audit Standards effective on 1 January 2004. However, we do not agree that our existing procedures are not proactive since that is how the noted instances were revealed. Although the Audit Staff has not and is unlikely to conduct non-audit work in the future, we will include procedures in our manual to address the possibility of doing such non-audit work.

IPA Independence Documentation Requirements

The Peer Review believes that the OIG should require its IPA contractor to comply with the Government Auditing Standards concerning independence and made the following recommendation:

Peer Review Recommendation: We recommend that the Assistant Inspector General for Audits include in its statement of work for audit services specific requirements for complying with the Government Auditing Standard on Independence and required documentation to ensure that the organization as well as individual auditors are complying with the independence standard. The Statement of Work should include compliance with standards related to non-audit work by both the organization and the individual auditors related to the audit objectives and NRO.

NRO IG Response: Concur. For the next IPA contract, we will modify the Statement of Work to reflect the updated Government Auditing Standards requirements concerning auditor independence. With regards to non-audit work, the IPA will not be performing any non-audit work as part of this contract.

Financial Statement Audit-Contractor Oversight and Quality Assurance Working Papers and Quality Assurance Plan

The Peer Review noted that "the majority of NRO IG contractor oversight and quality assurance workpapers were not prepared and reviewed until after the audit report on the FY 2002 financial statements and transmittal memorandum" were issued in January 2003.

Peer Review Recommendation: The Assistant Inspector General for Audits revise its oversight procedures to ensure documentation of its oversight is complete before issuing its transmittal report accepting the contractor's opinions, conclusions, and recommendations relative to its contracted audit services and perform quality assurance procedures that are acceptable to perform after report issuance for lessons learned separate from oversight procedures.

NRO IG Comments: The Peer Review statements do not properly explain the condition. At the time the audit report is issued and transmitted, all IPA workpapers are complete. Our

responsibility up to that point is to provide oversight of the IPA's work and to ensure that sufficient testing has been performed to support their opinion. Once the report has been issued and transmitted, the quality assurance of the IPA's workpapers is completed.

NRO IG Response: Concur. In order to clarify this process, we will divide the Quality Assurance Program (QAP) into two parts: oversight and quality assurance. The oversight part will reflect the requirements outlined in the GAO/PCIE Financial Audit Manual, section 650, "Using the Work of Others," and will be completed prior to issuance of the report. The quality assurance part of the QAP will be performed after the report is issued and will form the basis for best practices or lessons learned.